

Under Minn. Stat. § 256B.501, subds. 2 and 3, the Commissioner clearly has delegated authority to promulgate rules regulating the Medical Assistance rates ICF/MRs are entitled to receive. Moreover, due to the mandatory rulemaking requirements in the statute, rules establishing and regulating those payment rates are needed. Therefore, except as hereinafter found to the contrary, it is concluded that the rules proposed by the Department are authorized and needed.

9. In drafting these rules the Department considered the recommendations in the reports of the Legislative Auditor (LAC Report) and the Rule 52 Task Force, as well as the directives, policies and programs contained in the federal and state laws relating to the care of mentally retarded persons.

10. Prior to 1973, the Medical Assistance program for ICF/MRs was administered by individual counties. In 1973, the state began regulating them on a uniform basis. At that time Rule 52 (12 MCAR § 2.052) was adopted by the Department of Public Welfare to establish payment rates for those facilities. Due to the Legislative changes that occurred in 1983, Rule 52 was repealed by the Department and temporary rules were enacted to replace it. Those rules, codified as 12 MCAR §§ 2.05301 - 2.05315 [Temporary] ("Rule 53T") became effective on January 1, 1984. These rules are designed to replace those temporary rules. They are to be effective on January 1, 1986 and govern the calculation of rates beginning with the rate year commencing on October 1, 1986.

11. Under Rule 52 each provider's per diem rate was recalculated annually based upon its costs in the previous year increased by projections for known or anticipated cost changes. The total costs recognized in that process were divided by resident days to determine a per diem rate for the next rate year. Rule 53T retained a prospective rate setting system but included new measures to contain costs. The rules prohibited increasing the basis of assets upon sale, limited interest rates, included incentives to renegotiate high interest loans and required a 20% down payment when acquiring new capital assets. The rule also required ICF/MRs to put aside depreciation payments in a funded depreciation account so that money would be available to the provider to meet increased mortgage payments. Known cost changes recognized under Rule 52 were eliminated, and replaced with a straight indexing methodology. Top management compensation was limited and incentives for efficient management were included. Under Rule 53T, operating costs were divided into three separate categories for the first time, and facilities were paid a 27¢ operating cost adjustment designed to compensate them for the risk involved in operating their programs. To calculate a rate under Rule 53T, a facility's allowable operating and property costs were divided by the greater of actual resident days or 85% of resident days increased by changes in the Consumer Price Index (CPI).

#### DEFINITIONS

##### 9553.0020, subp. 5, Capital Assets

12. This subpart defines capital assets as "a facility's land, physical plant, land improvements, depreciable equipment, leasehold improvements, and

all additions to or replacements of those assets." There were no adverse comments on this definition and it is necessary and reasonable. However, it does not clearly cover improvements and repairs to capital assets which must be capitalized under 9553.0035, subp. 8. Such capital improvements are not the same as additions (defined in 9553.0020, subp 2) or replacements. Therefore, the Department may wish to include capitalized improvements and repairs under 9553.0035, subp. 8, item B in this definition.

9553.0020, subp. 6, Capital Debt.

13. In response to the suggestion of William J. Hargis, President of the Minnesota Association of Health Care Facilities (MAHCF), the Department proposes to amend this definition to include points, financing charges, and bond premiums or discounts. The amendment is necessary to clarify the meaning of the rule. As amended, the rule is necessary and reasonable, and the amendment made does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985).

9553.0020, subp. 15, Depreciation Guidelines.

14. The depreciation guidelines covered by this definition are those contained in an American Hospital Association publication. They are to be used only to classify assets as attached fixtures (fixed equipment), land improvements, buildings and depreciable equipment (major movable equipment). The guidelines are not intended to be used to determine the useful lives of assets even though they contain such figures. The guidelines were recently established and cover many of the types of equipment found in ICF/MRs. Therefore, it is concluded that their use, as well as the definition proposed, is necessary and reasonable.

Ms. Martin suggested that the guidelines are inappropriate because they pertain to medical facilities that purchase specialized equipment while ICF/MRs primarily purchase household goods and small business items. She concluded that it is unnecessary to use them at all. The Administrative Law Judge is not persuaded that the guidelines are inapplicable to ICF/MRs. Some residents suffer from disabilities other than mental retardation and have special medical needs. The guidelines will likely be relevant to the classification of medical equipment for such residents. They will also be relevant to larger facilities whose operations, plant and equipment are similar to those of state hospitals. Under these circumstances, the Department reasonably concluded that the guidelines will be useful, and that it is preferable to having no guidelines at all.

9553.0020, subp. 16, Desk Audit.

15. This subpart defines a desk audit as follows:

Subp. 16. Desk Audit. "Desk audit" means the determination of the facility's payment rate based on the commissioner's review and analysis of required reports, supporting documentation, and work sheets submitted by the provider.

Mary Martin questioned the propriety of the Department's desk audit procedures. She, like many other industry speakers, argued that one of the major problems ICF/MRs face is the Department's failure to set timely rates, making it impossible for them to operate with a reliable budget and exposing them to cost paybacks of money spent. She went on to describe the delays that have occurred under Rule 53T. That rule was effective January 1, 1984, but most ICF/MRs do not yet have a final Rule 53T rate. The current backlog under Rule 53T is anywhere from 100 to 200 cases, and 178 cost reports have not yet been completed for rate setting purposes. In conversations she had with Departmental staff on August 26, 1985, she was advised that cost reports require from 45 to 48 hours of a desk auditor's time to complete. Using that information, she projects that 347 cost reports will be unaudited as of March 3, 1986, and that facilities will not get timely rates under the new rules. To remedy this situation, Ms. Martin suggested that the Department change its desk audit procedures to reduce the time involved in the desk audit process and to expedite rate setting. To do that, she suggested that the Department adopt the Medicare definition of "desk audits and field audits".

16. The Department has declined to adopt the Medicare definitions of those terms. Medicare establishes a retrospective payment system. Under that system, the desk audit rate establishes an interim rate which is settled at the end of the year through a field audit. Under the rule proposed by the Department, however, prospective rates are established prior to the beginning of the rate year. Field audits occur three to four years later. For that reason, the Department has determined that the scope of its desk and field audits must be different than the scope of those audits under the Medicare program so that overpayments can be minimized. The Department agreed that it must take administrative measures to improve the timeliness of its rate setting activities, and as its auditors become more familiar with the new rules it expects the time required to complete them will decrease. It noted, for example, that the time it takes to perform desk audits under Rule 53T has been reduced to 35 hours, including supervisory staff time. It expects further reductions in the future.

In order to reduce overpayments and to fix accurate rates, the Department's decision to make a thorough desk audit review of cost reports filed is necessary and reasonable in spite of the delays which have occurred under Rule 53T. Decisions regarding the nature of the audits undertaken by an agency in spending public funds is one that should normally be made by the agency as such decisions are essentially rules of internal management which are exempted from the rulemaking provisions of the APA under Minn. Stat. § 14.02, subd. 4 (1984).

9553.0020, subp. 21, Fringe Benefits.

17. Ms. Martin criticized the proposed definition of fringe benefits because it includes worker's compensation insurance. She argued that worker's compensation insurance costs are more like a payroll tax and should be included within the definition of "payroll taxes". Insurance costs do not logically fit within either definition. Although unemployment taxes and benefits are sometimes referred to as "unemployment insurance", worker's compensation insurance is substantially different from unemployment compensation because no tax is levied against an employer. Moreover, there is no evidence that including worker's compensation insurance costs within the

definition of payroll taxes would result in any substantive change in the treatment of those costs. Under part 9553.0030, subp. 6, payroll taxes and fringe benefit costs are allocated in the same manner. Therefore, inclusion of worker's compensation insurance within either group will result in identical treatment under the rule. Under these circumstances, the Department's election to include them under the definition of fringe benefits is necessary and reasonable as proposed.

9553.0020, subp. 23, Historical Capital Costs.

18. This subpart defines the cost basis of capital assets. It generally provides that the historical cost basis is the current owner's basis unless there is or has been a change of ownership since January 1, 1984. In that case, the basis is the prior owner's basis. Increases in the basis of a capital asset due to changes in ownership after January 1, 1984 are not recognized because such increases merely raise Medical Assistance program costs without any corresponding resident benefits. The failure to recognize increases in the basis of capital assets first placed in use under the Medical Assistance program on or after January 1, 1984 is consistent with the recommendations in the LAC Report and with the provisions of the Deficit Reduction Act of 1984 (DeFRA). The definition is necessary and reasonable as proposed.

9553.0020, subp. 24, Indirect Costs.

19. Since the words "indirect costs" are used in the rule, and since their meaning is not readily apparent, a definition is needed. The definition proposed by the Department generally identifies them as costs incurred for the purpose of benefitting more than one cost category or costs that are not "readily assignable" to the cost categories benefitted. Ms. Martin suggested that the quoted words be replaced with the words "directly identified." In her view, such an amendment is more consistent with the definition of direct costs and the direct cost identification requirements in part 9553.0030. The use of consistent terminology to describe the same concept is important. Since the Department's SNR indicates that the concept of direct identification is to be applied, it should use that language here and in part 9553.0020, subp. 17 (page 3, line 11).

9553.0020, subp. 32, Physical Plant.

20. The words "physical plant" are defined, in part, as follows:

. . . the building or buildings in which a program licensed to provide services to persons with mental retardation . . . is located, and all equipment affixed to the building . . . and storage sheds located on the same site if related to resident care. Physical plant does not include buildings or portions of buildings used by central, affiliate [sic], or corporate offices [emphasis added].

Ms. Martin suggested that the last sentence of this definition be deleted. She noted that the exclusion of "corporate offices" would make the office costs of providers that are not part of a provider group general and administrative costs contrary to the Department's stated intent.

The costs of central, affiliated and corporate offices which are not located on the premises of a licensed facility are required to be treated as administrative costs. However, offices located on the premises of an ICF/MR are treated as property-related costs. The definition suggests that if part of a licensed ICF/MR is used as an administrative office, that portion is not part of the physical plant and is not recognized as a property-related cost. Ms. Martin noted that this is not the Department's intent. The reference to "portions of buildings" is not intended to include portions of a licensed facility used as an administrative office. Since the definition does not clearly state the Department's intent, it is impermissibly vague for purposes of Minn. Stat. § 14.02, subd. 4. This constitutes a substantive violation of law for purposes of Minn. Stat. § 14.50. To correct this defect the definition must be clarified to state when office space on the premises is not a property-related cost. That could be done by adding the following language to the last sentence: "but does include office space on the premises of a licensed facility."

9553.0020, subp. 38, Rate Year.

21. This rule establishes a uniform rate year for all ICF/MRs. It is the period from October 1 to the following September 30 of each year. The Department determined that a uniform rate year should be instituted in order to establish a consistent historical base for all providers, to improve the ability of the Department and providers to forecast budgets and to make it possible for the Department to automate the rate paying system. For those reasons the proposed definition is necessary and reasonable and may be adopted. Having a uniform rate year does require a uniform reporting year, as is discussed below.

9553.0020, subp. 39, Related Organization.

22. A definition of related organizations is necessary because the rules contain several provisions relating to the costs incurred by related organizations or costs incurred by facilities due to their relationship to such organizations. The definition proposed is similar to that used in the Medicare program, in federal securities law and in Departmental rules governing the establishment of reimbursement rates of nursing homes under the Medical Assistance program. The definition establishes a control test for determining which organizations are related. Control is defined in the rule as "the possession, direct or indirect, of the power to direct or cause the direction of the management, operations, or policies of a person, whether through the ownership of voting securities, by contract or otherwise." James Selfert, a certified public accountant, suggested that the word "possession" be changed to "exercise," and Ms. Martin suggested that a percentage test be used to establish whether or not control exists. Whether or not a related organization actually exercises control may be a factor in determining whether control exists. However, as the Department pointed out, substituting those words could lead to a great deal of confusion and unnecessary litigation if an organization clearly having control alleged that it did not exercise it in a particular case. In view of the common usage of the definition proposed here, especially its approved usage for purposes of nursing home regulation, it is concluded that the definition proposed by the Department is necessary and reasonable. Although the words "possess" and "control" have similar meanings, the definition is not confusing, the word "possess" in the definition simply means to hold or to have the power mentioned.

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Moreover, since actual control may exist even where an ownership interest is less than 51%, the Department's decision not to adopt a percentage figure has a rational basis. A percentage test does have some advantages over a control test, however. It is a definite standard that is easy to apply. Therefore, it would generate less confusion and litigation. Since it is unlikely that control will exist if less than 50% of the ownership of an organization is controlled, the Department should reconsider its decision not to adopt a percentage test. At the very least, it is recommended that it create a presumption of no control when less than 50% of the ownership of an organization is controlled, by adding the following sentence to the end of item D:

For purposes of this subpart, there is a presumption of no control with less than 50% ownership of an organization.

Agencies have the power to adopt presumptions in their rules. Juster Bros. v. Christgau, 214 Minn. 78, 7 N.W.2d 501, 507 (1943). Using a presumption or percentage test here would not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985).

9553.0020, subp. 40, Repair.

23. This subpart defines a repair as "the cost of labor and materials needed to restore an existing capital asset to sound condition after damage or malfunction or to maintain an existing capital asset in a usable condition." This definition is consistent with its generally accepted meaning. As a general rule the word means the restoration of an asset to a sound, good or complete state after decay, waste, injury, dilapidation or partial destruction. As such, it is concluded that the definition proposed is necessary and reasonable.

9553.0020, subp. 42, Reporting Year.

24. Under the proposed rules, the reporting year is defined as follows:

. . . the period from January 1 to December 31 immediately preceding the rate year, for which the provider submits its cost report, and that is the basis for the determination of the total payment rate for the following rate year.

The Department proposes a common reporting year for all facilities in order to obtain uniformity of treatment under the rules and to obtain historical information from a uniform time period. Using a uniform reporting year will help the Department monitor expenditures, forecast budgets and implement an automated rate paying system. It will also provide the Department with an accurate data base which it can use to evaluate and compare facility costs. The Department elected to adopt a reporting year ending on December 31 because a plurality of ICF/MRs (36.7%) now have fiscal years ending on December 31. Although approximately 23% have fiscal years ending on June 30, the second most common period currently in use, the Department decided that it would be least disruptive to use the December 31 date. A December 31 year end has other advantages. Coupled with an October 1 rate year, it provides a 9-month time lag during which cost reports can be filled and the desk audit can be

completed. This time lag will be necessary given the current backlog and the delays which might arise while everyone becomes familiar with the new provisions contained in the rule.

The decision to have a uniform reporting year ending on December 31 was criticized by many industry speakers who noted that a reporting period ending on December 31 will increase facility costs because their accountants will be busy with routine tax matters at that time of the year and the cost of their time will be at a premium. In spite of these criticisms, it is concluded that the rule is necessary and reasonable. The benefits to be obtained from using a December 31 reporting year end outweigh the disadvantages. The fact that costs are increased does not make the rule unreasonable. Cost factors are a separate issue which must be separately considered.

25. Ms. Martin argued that the rule is impermissibly retroactive because its reporting requirements will apply to costs incurred in 1985 and contains retroactive requirements some facilities will be unable to meet. To correct this, she proposed that calendar year 1986 be used as the first reporting year and that the first rate year be October 1, 1987.

In support of her argument that a rule cannot have retroactive effect, she cited the definition of a rule in Minn. Stat. § 14.02, subd. 4, which states, in part, that a rule is an "agency statement of general applicability and future effect." The "future effect" language in that statute does not prohibit the adoption of rules with retroactive effect. The federal Administrative Procedure Act contains similar language. In Colyer v. Harris, 519 F.Supp. 692, 696-98 (S.D. Ohio 1981) the Court held that those words were added to the federal act to distinguish rulemaking from contested cases and not to prohibit retroactive rules. The Court went on to hold that retroactive rules can be adopted. That holding is consistent with the usual holding that rules, like statutes, may be made retroactive if it is reasonable to do so. Summit Nursing Home, Inc., v. United States, 572 F.2d 737 (Ct.Cl. 1978); Mason v. Farmers Insurance Companies, 281 N.W.2d 344, 348 (Minn. 1979). Therefore, it is concluded that a rate year based upon costs incurred in 1985 is not impermissibly retroactive. That is not to say that some provisions of the rule may be impermissibly retroactive if the Department attempts to apply them retroactively. For example, if deadlines or procedures are applied retroactively to the detriment of a facility, that application may be improper. For purposes of this Report, however, it is not feasible to examine the validity of every possible retroactive application of the rule. Where, reasonable, retroactive effect is permissible. When retroactive effect will deprive facilities of vested rights, make compliance impossible, or otherwise be unreasonable, the Department will have to make necessary adjustments.

9553.0020, subp. 45, Top Management Personnel.

26. Under the rule, top management personnel are defined as follows:

"Top management personnel" means owners, corporate officers, general, regional, and district managers, board members, administrators, facility administrator, and other persons performing executive functions normally performed by such personnel, whether employed full time, part time,

or as a consultant. The facility administrator is the person in charge of the overall day-to-day activities of the facility.

The rule contains several limitations on top management costs and provisions regulating the classification and allocation of those costs. Hence, a definition of top management personnel is necessary. Past definitions of the term have been a constant source of disputes between the Department and the industry and there is no present consensus on the definition that should be used.

According to the Department's SNR (p. 14), the definition is designed to identify those persons who perform substantial executive functions, regardless of their title or the number of hours they work. For that reason, ARRM suggested that the term be defined as "that person or persons, whether full or part time, vested with executive policy making functions for the provider or provider group." The Department refused that suggestion and the amendments proposed by other interested persons.

The word "executive" normally means the person or group having administrative or managerial authority in an organization. The American Heritage Dictionary of the English Language, pp. 458-459 (1981). ARRM's proposed definition, which concentrates on policy-making functions, is considerably narrower than that usually accorded to the word "executive" and is at variance with the Department's intent.

Under the proposed definition, top management begins with the person in charge of the overall day-to-day activities of the facility -- the facility administrator. This is the person who has broad managerial and administrative authority over the facility. Persons performing those duties, whether full or part time, are covered by the rule. In addition to facility administrators, the rule specifically mentions other positions: owners, corporate officers, board members, area managers and administrators. All of these individuals would be in positions of greater executive authority and responsibility. Any person who performs the duties commonly required of persons holding such positions would be top management, regardless of their titles or the amount of time devoted to such duties.

27. The proposed definition was addressed in great detail by David Bjork, PhD., an expert in executive compensation and job design and analysis, who spoke on behalf of ARRM. In his view, the definition proposed by the Department lacks objective criteria and is so ambiguous that it will be susceptible to arbitrary retroactive application by Departmental personnel. He noted that top management is usually equated with executive responsibilities and that some of the examples included in the definition are not generally considered to be top management personnel but middle or lower level managers or administrators. He testified that in organizations of similar size to ICF/MRs he would expect to find, at the most, three top management personnel and in most cases only one. He also testified that owners and board members are never included within top management unless they have an insider position and executive responsibilities. In his view, including facility administrators in the definition of top management is inconsistent with customary business classifications, which generally restrict top management to a higher organizational level, office or title. In

organizations like ICF/MRs, he argued that top management should be restricted to the chief executive officer, regardless of title. In a larger provider group, he might also include someone like an executive vice-president. In his view, executive functions are generally those in the areas of policy making: direction setting, major capital allocation decision making, and dealing with top level external relations.

28. In spite of Dr. Bjork's criticism, it is concluded that the rule is sufficiently specific, necessary and reasonable. That is not to say that its application will be a simple matter in every case. The record shows that ICF/MRs have a variety of management structures and job descriptions. In close cases, an individual's duties may be difficult to classify because of the particular mix of the duties performed. In those situations, a case-by-case determination must be made in determining whether all or part of the duties are top management in nature. Simply because an after-the-fact decision will be necessary in some cases does not mean, as Dr. Bjork implies, that the decision will be arbitrary. On the contrary, those decisions will depend on the nature, quality and quantity of the duties performed. If they involve the management or administrative duties usually performed by facility administrators or the other positions named, they will be in top management. Otherwise they will not.

Dr. Bjork also criticized the lack of objective standards in the rule and the Department's unconventional use of ordinary terminology. Peter Sajevec also criticized the Department's failure to adopt a functional definition or listing of top management duties. Those arguments are also unpersuasive. Rules should be specific, but where it is not feasible to make them so, a general rule will suffice. Can Mfrs. Institute, Inc., v. State, 289 N.W.2d 416 (Minn. 1979). In this case no objective criteria were proposed for adoption and the Administrative Law Judge is persuaded that it is not feasible to promulgate a list of specific duties that would constitute top management or a functional definition that would be more precise, and that some case-by-case determinations will be necessary due to the diversity of management structures and job descriptions which admittedly exist.

The Department's definition of top management may be inconsistent with that generally used in corporate circles, as Dr. Bjork argued. However, that does not make the rule unnecessary or unreasonable. The Department may define the meaning of the words it uses. The reasonableness of the definition does not depend on whether the definition is consistent with that ascribed to it in a different context. Therefore, the focus of the inquiry must be on the definition proposed, not the word defined. Dr. Bjork concentrated on the word rather than the definition. He noted, for example, that owners are not generally considered to be top management. While that may be true, the issue to be decided is whether the compensation paid to such persons should be included in the definition of those persons whose compensation is to be limited. He offered no reasons why they should not.

29. Mark Larson, Messerli & Kramer, Attorneys at Law, who appeared on behalf of REM, Inc., also questioned the meaning of the definition. He noted that it is unclear whether the day-to-day activities referred to in the rule are limited to business activities, or whether they include program activities. Due to REM's system of having one off-site administrator for several facilities, and an on-site director at each facility who is primarily

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responsible for program and resident care needs, he was concerned that REM's program directors might be treated as top management because the definition mentions both administrators and facility administrators. He suggested, therefore, that program directors be excluded from the definition. The Department rejected his amendment because some program directors have more than nominal top management duties and responsibilities. The rule is necessary and reasonable without the amendment. If a program director does not perform the duties of the positions listed in the rule, that director will not be included in top management. It is unnecessary to list positions not covered. The rule lists that which it covers, not that which is excluded. Although the Department did not explain the distinction between administrators and facility administrators, the former apparently includes any higher level person who supervises or directs the facility administrator or shares his responsibilities. If a different meaning is intended, a clarification should be made.

### COST CLASSIFICATION AND ALLOCATION PROCEDURES

30. Part 9553.0030 governs the identification, classification and allocation of costs incurred by ICF/MRs. It requires them to compile a total cost figure for each cost category and to report those totals on the annual cost report they are required to file. The cost categories to which costs must be "classified" are those listed in part 9553.0040. They include: program operating costs, administrative operating costs, maintenance operating costs, payroll taxes and fringe benefits, and property related costs. Since separate rates are computed for each operating cost category, and since the reporting requirements in this rule are needed to establish facility rates and in order to enable the Department to audit a facility's books and records, these provisions are necessary and reasonable.

#### 9553.0030, subp. 1, item A.

31. Under item A, a cost that can be directly identified to a cost category must be classified (assigned) to that category. If direct identification to one or more cost categories is not possible, allocation is not permitted except as the rule otherwise provides. Instead, the cost must be classified to the administrative cost category. Under the rule, costs must be directly identified and classified to the appropriate cost category when they are recorded in the facility's books and records. Direct identification by the facility at the time transactions are recorded in its records is necessary and reasonable because it facilitates Departmental audits. The direct identification procedure requires that costs which cannot be specifically classified to one or more cost categories must be classified to the administrative cost category since they benefit the facility as a whole (SNR, p. 15). Cost classification is necessary and reasonable in order to have costs uniformly reported by all facilities so that those costs can be compared for rate setting purposes. In addition to facilitating review by Departmental auditors, it promotes the uniform treatment of providers and enables the Department to properly enforce cost limitations.

#### 9553.0030, subp. 1, item B.

32. Under this item, costs that cannot be directly identified with any particular cost categories must be classified to the administrative cost category. Indirect costs, such as generic supplies, would fall under its